COMMERCIAL RENT ARREARS RECOVERY

ARE YOU READY FOR THE CHANGES

ON 6TH APRIL 2014?

Landlords have for a long time used the common law remedy of distress, which enables them to seize the goods of their tenant at the leased premises and sell those goods at auction, in order to recover any rent arrears. However, distress for commercial rent arrears will be abolished by the Tribunals Courts and Enforcement Act 2007 via the Taking Control of Goods Regulations 2013, which were published last month. These reforms create a new process called Commercial Rent Arrears Recovery (CRAR) which landlords must abide by when seizing a tenant's goods for failure to pay rent. The changes are due to come into effect in April 2014.

Executive summary

Distress is an invaluable and frequently used remedy for the recovery of arrears. Its replacement by commercial rent arrears recovery ("CRAR") from 6 April 2014 causes a significant problem for landlords. The requirement with CRAR to serve prior notice gives tenants an opportunity to put goods out of landlords' reach and undermines the remedy. Whilst seeking to protect tenants' human rights and create a more level playing field between landlord and tenant, many landlords will perceive that CRAR has gone too far in helping tenants. The changes also weaken a superior landlord's right to recover rent from sub-tenants, if a tenant of the superior landlord is in arrears.

The new procedure is highly technical and this note summarizes the key points.

Current position - distress or distraint

Landlords, currently, have the common law self-help remedy of distress, which enables them to seize tenant's goods, if the tenant fails to comply with its lease obligation to make a payment reserved as rent, provided it is for a certain amount. So distress not only applies to principal rent, but also to any other payment reserved as rent, which usually includes insurance premiums, VAT and any service charge.

Distress is a cheap and effective way of recovering rent arrears. It is widely used by landlords for payments, large or small. An important part of distress is that it can take tenants by surprise (no prior notice or court order is required except in certain insolvency situations), meaning that the tenant does not have an opportunity to put its goods out of the landlord's reach. The very fact that bailiffs turn up and seize the goods can be sufficient encouragement for the tenant to pay the arrears without the goods having to be sold by the bailiff.

Distress is often a trigger event in a forfeiture clause for a landlord's forfeiture of a lease by peaceable re-entry, although if a tenant breach has occurred which would otherwise allow the landlord to forfeit, subsequent "distraining" will waive the landlord's right to forfeit for that breach. If forfeiture has taken place, the distress remedy cannot be used. So landlords cannot both forfeit and distrain for a tenant's breach.

Objections to distress, primarily based on interference with the tenant's human rights, led to the Tribunals Courts and Enforcement Act 2007. This introduced the concept of "commercial rent arrears recovery" (or CRAR) to replace distress. However, while the 2007 Act received Royal Assent in 2007, it will not be until6 April 2014that the CRAR regime will come into force (as a result of the Taking Control of Goods Regulations 2013) and distress will be abolished.

Position from 6 April 2014 - "commercial rent arrears recovery" (or CRAR)

The key motivation behind the introduction of CRAR is to redress the balance between the respective positions of the landlord and tenant. Rather than the landlord having pretty much free rein to distrain, there are a number of new pre-conditions that must be satisfied before CRAR can be utilised. So CRAR will be a much less useful remedy for landlords than distress. That is a serious issue for landlords in view of the effectiveness and regularity of use of distress over the last three hundred years or more. The following examples, in the main, demonstrate why CRAR is an inferior remedy for landlords.

Does there have to be a minimum amount of arrears before CRAR can be exercised?

Yes, an amount (known as "net unpaid rent") equal to seven days' rent. There is no minimum amount for distress. Since landlords will often distrain for minimal amounts, CRAR is disadvantageous to landlords. Landlords should note that, in calculating the amount of net unpaid rent, there is deducted any interest or VAT included in the arrears and any deduction, recoupment or set-off that the tenant would be entitled to claim (in law or equity) in an action by the landlord for that rent. The "net unpaid rent" test must be satisfied both when the advance notice referred to below is given and when control is first taken of goods pursuant to that notice.

Does CRAR apply to any payment reserved as rent?

No, unlike distress, it only applies to principal rent, VAT and interest. So it does not apply to service charge, insurance premiums, rates or other payments reserved as rent. Distress is an invaluable remedy for recovering service charge and other such payments and the fact that CRAR cannot be used for that purpose makes it an inferior remedy for landlords. If there is an inclusive rent (including service charge etc), CRAR will only be available for that part of the rent "reasonably attributable" to possession and use of the premises. It only applies to rent that has become due and payable before the advance notice referred to below is given and that is certain, or capable of being calculated with certainty.

Following the ending of a lease (which includes statutory continuation), CRAR continues to be exercisable in relation to rent due and payable before the lease ended, provided certain conditions are met. They include that the lease did not end by forfeiture; not more than 6 months have passed since the day when it ended; the "tenant" remains in possession of any part of the premises; and the person who was the landlord at the end of the lease remains entitled to the immediate reversion. Landlords should watch that time limit for using CRAR.

Can CRAR be used if the lease is of mixed-use (commercial and residential) premises?

No. CRAR cannot be used for a lease if the premises are let by that lease wholly or partly as a dwelling, or let under a sub-lease wholly or partly as a dwelling, or are occupied as a dwelling. However, CRAR can be used, potentially, where the letting under the sub-lease or occupation as a dwelling is in breach of lease terms. By contrast, with a mixed-use lease, distress is permitted in the commercial part of the premises.

Does CRAR require advance notice to be given to the tenant?

Yes, at least seven clear days' prior notice, excluding Sundays, Bank Holidays, Good Friday and Christmas Day, is required. This notice is known as a "notice of enforcement". No prior notice was

required for distress. This is one of the major disadvantages of CRAR, in that the surprise element is removed. The theory is that the notice period gives the tenant the opportunity to pay the arrears to prevent the "enforcement agent" (the equivalent of the bailiff under distress) turning up. The probable reality, however, is that once the tenant has received notice that CRAR is to be exercised, the tenant has at least seven clear days, in which to remove its goods from the premises and undermine CRAR's effectiveness.

In practice, some tenants may find it inconvenient to start removing their goods, so CRAR's weakness may not be exploited in every situation. Nevertheless, the notice requirement makes CRAR considerably more ineffectual than distress.

While in certain circumstances a court can reduce the length of the notice period, the tenant will still be entitled to some prior notice. There are detailed requirements for the form of the notice (where mistakes can occur, potentially, invalidating the notice) and the notice must be given by the enforcement agent or its office, not the landlord's solicitor.

At what times can CRAR be exercised?

Between 6am and 9pm on any day of the week. CRAR can also be exercised outside those hours if the premises are open for trade. Distress can be levied between sunrise and sunset on any day except Sunday or a public holiday, so "you win some, you lose some" with CRAR on this comparison, with CRAR perhaps being slightly more flexible.

Which goods can be seized under CRAR?

They have to be goods owned by the tenant. Goods owned by a sub-tenant or other third party are not available. Tools of the tenant's trade are exempt from CRAR up to an aggregate value of £1,350 - beyond that, CRAR can apply to such tools. With distress, all tools of the tenant's trade are exempt with no financial limit. In that respect, CRAR is more favourable to landlords. Broadly with CRAR, an enforcement agent may not take control of goods whose aggregate value is more than the amount outstanding, and an amount in respect of future costs.

How does the CRAR procedure for securing the tenant's goods for the landlord compare to distress?

With distress, following the seizure of the tenant's goods by the bailiff, the goods can remain in the premises, but the bailiff grants the tenant a "walking possession agreement". This identifies the goods seized and sets a timetable for the tenant to pay the arrears. If the arrears are not paid, the bailiff can return and remove and sell the goods.

With CRAR, to "take control of" goods, an enforcement agent must secure the goods on the premises on which he finds them; remove them and secure them elsewhere; or enter into a controlled goods agreement with the tenant. The walking possession agreement is replaced with a Controlled Goods Agreement ("CGA"). A CGA is an agreement under which the tenant is permitted to retain custody of the goods, acknowledges that the enforcement agent is taking control of them, and agrees not to remove or dispose of them, nor to permit anyone else to, before the debt is paid. While the CGA is more heavily regulated, it appears to be more flexible in terms of who can enter into it on the tenant's behalf. Anyone authorised by the tenant or someone with the tenant's apparent authority can enter into the CGA with the enforcement agent.

If an enforcement agent takes control of goods, he must provide the tenant with an inventory of them as soon as reasonably practicable. Only an enforcement agent may take control of goods and sell them under an enforcement power. An enforcement agent, if he is not the person on whom an enforcement power is conferred, may act under the power only if authorised by that person.

The enforcement agent may not take control of goods after 12 months have expired from the date of the notice of enforcement.

Can the enforcement agent immediately re-enter if the CGA is breached?

No, at least two clear days' prior notice must be given. The notice period also excludes Sundays, Bank Holidays, Good Friday and Christmas Day. This is in contrast to distress where no prior notice is required before re-entering the premises. Once again, this prior notice requirement for CRAR gives the tenant the opportunity to put the goods beyond the enforcement agent and the landlord. In that regard, CRAR is an inferior remedy to distress.

Is any further notice required to sell the goods under CRAR?

Yes, at least seven clear days' notice must be given by the enforcement agent of the date, time and place of the sale of the goods. There are certain exceptions where a shorter period applies, for example, where the goods may perish. The minimum period before sale is seven clear days from removing the goods for sale. If the seven days' notice is not given, the goods are deemed to be abandoned by the enforcement agent and they have to be returned to the tenant. Any notice must be given within 12 months beginning with the day on which the enforcement agent takes control of the goods, otherwise the goods are treated as abandoned and they have to be returned to the tenant. By contrast, with distress, the bailiff has to wait only five days, so CRAR fails again by comparison with distress from the landlord's perspective.

With CRAR, there is, usually, at least 16 clear days' notice in total that needs to be given to the tenant before the goods can be sold. This is contrasted with 5 days' notice for distress.

If the proceeds from a sale are more than the amount outstanding, the surplus must be paid to the tenant.

Right to recover rent from sub-tenant

A superior landlord, currently, has a right to recover rent from a sub-tenant (if the superior landlord's tenant is in arrears) under section 6 of the Law of Distress Amendment Act 1908. This right is replaced from6 April 2014by a similar, but (from a landlord's perspective) less useful right under section 81 of the Tribunals Courts and Enforcement Act 2007. The right applies where CRAR is exercisable and, to exercise the right, the superior landlord must serve a notice on sub-tenants stating the amount of rent that the superior landlord has the right to recover from its tenant by CRAR.

When it takes effect, the notice served on the sub-tenant transfers to the superior landlord the right to recover, receive and give a discharge for any rent payable by the sub-tenant under the sub-lease, until the notified amount has been paid, or the notice is replaced or withdrawn. Rent means principal rent, VAT and interest, but does not include service charge, insurance premiums, rates or other payments reserved as rent. As stated above, rent for the purposes of distress, has a wider meaning, extending to any payment reserved as rent. So the new right catches fewer payments by the sub-tenant.

Another problem for the superior landlord is that the notice does not take effect immediately (unlike the current position), but instead the superior landlord has to wait for 14 clear days after the notice is served. The problem with the 14 days' delay is that if the superior landlord's tenant recovers the rent from the sub-tenant during those 14 days, the notice will not catch the sub-tenant until it becomes liable for its next rent instalment, which can lead to significant delays if the rent is paid quarterly in advance. This 14 day delay undermines the effectiveness of this remedy for superior landlords.

If the superior landlord is entitled to be paid rent by the sub-tenant and the sub-tenant fails to pay, the superior landlord can use CRAR against the sub-tenant.

For any amount that a sub-tenant pays under a notice under section 81, he may deduct an equal amount from the rent that would be due to his immediate landlord under the sub-lease.

Moratorium

If the tenant is in administration, there is a moratorium on instituting or continuing legal process (including legal proceedings, execution, distress and diligence) against the tenant or its property, without the court's permission or the administrator's consent. A moratorium also applies for certain other insolvency events. The 2007 Act introduces a new definition of "distress" into the Insolvency Act 1986, which includes the taking control of goods procedure that underpins CRAR. So the moratorium will catch CRAR in the way that it, currently, catches distress.

Conclusion

The requirement for the prior notice has emasculated CRAR and undermined its effectiveness. In view of the fact that distress is a regularly used and potent remedy for landlords if there are rent and service charge arrears, this statutory change creates a serious issue for landlords. It may incline landlords to seek rent deposits on a more regular basis, which they can dip into in the event of tenant breach without undue administration. The changes have also weakened the superior landlord's right to recover rent from a sub-tenant if the superior landlord's tenant is in arrears.